No. 15950

In the United States Court of Appeals for the Ninth Circuit

BIDART BROS., A CORPORATION, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States District Court for the Southern District of California

BRIEF FOR THE APPELLEE

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CITATIONS

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OPINION BELOW

The opinion of the District Court (R. 18-30) is reported at 157 F. Supp. 373.

JURISDICTION

The taxpayer filed its income tax return for the fiscal year ending April 30, 1952, within the time required and paid the tax shown thereon. Thereafter the Commissioner of Internal Revenue made a deficiency assessment in the amount of $107,258.90 which was also paid. A timely claim for refund of the deficiency payment was filed on or about April 13, 1956 (R. 5-9), and was rejected by the Commissioner

on February 4, 1957 (R. 9). Within the time provided in Section 3772 of the Internal Revenue Code of 1939 and on March 11, 1957, suit for refund was instituted by a complaint filed in the District Court. (R. 1-9, 32-34.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. Judgment was entered against the taxpayer on January 10, 1958. (R. 35.) Notice of appeal to this Court was duly filed on February 13, 1958. (R. 35-36.) This Court has jurisdiction under 28 U.S.C., Section 1291.

QUESTION PRESENTED

The taxpayer was lessee of several parcels of land and sold such leases during the taxable years along with the unharvested crops on the leased land. The question is whether the net profit from the sale of such crops must be taxed as ordinary income as the District Court held or can be taxed as capital gain under Section 117(j) of the Internal Revenue Code of 1939, as the taxpayer contends.

STATUTE AND OTHER AUTHORITIES

The pertinent provisions of the statute and other authorities appear in the Appendix, *infra*.

STATEMENT

The facts as found by the District Court are as follows (R. 31-34):

The taxpayer is a California corporation having its principal place of businesss at Saco, Kern County, California. It filed a timely income tax return for its fiscal year ending April 30, 1952 (the taxable year

involved here), and paid the tax shown thereon. (R. 31-32.)

The taxpayer was the lessee of several parcels of land upon which it grew a variety of crops such as hay, cotton and seed alfalfa. The leased lands had been held by the taxpayer for a period in excess of six months when during the fiscal year involved here, it sold its leases on such land together with the unharvested crops thereon. Such sale was made to Wheeler Farms, a partnership. (R. 32.)

In its federal income tax return for such fiscal year, the taxpayer reported the sale of the leases and the unharvested crops on the leased land as a single transaction and treated the entire gain from this sale as a long term capital gain. The gain on the leases amounted to $244,925.73 and on the unharvested crops $237,954.56. The taxpayer also reported gain from harvested crops which it treated as ordinary income (R. 32-33.)

The Commissioner accepted the taxpayer's treatment of the gain on the leases and on the harvested crops but did not accept the taxpayer's treatment of the unharvested crops as capital gain. Accordingly the Commissioner determined a deficiency in the amount of $107,258.90. That amount was then paid by the taxpayer and a claim for refund was filed. Such claim was rejected by the Commissioner on February 4, 1957. (R. 32-34.)

The District Court decided that the taxpayer had not sustained its burden or proving that the gain from the sale of unharvested crops on leased land is within the provisions of Section 117(j)(3) of the

Internal Revenue Code of 1939 and that the taxpayer is not entitled to any refund of taxes paid for the fiscal year ending April 30, 1952. Accordingly the District Court held that the taxpayer's complaint be dismissed with prejudice. (R. 34-35.)

SUMMARY OF ARGUMENT

During the taxable year here, the taxpayer sold unharvested crops to the same partnership and at the same time it sold its leases on the land where the crops were growing. Taxpayer contends that it can treat the gain realized from the sale of crops as capital gain under 1939 Code Section 117(j)(3). But the District Court held that such gain must be taxed as ordinary income because the sale of the lease did not constitute a sale of land and that a sale of land was required by the statutory provision relied on. We submit that the court's decision is a reasonable and proper interpretation of Section 117(j)(3).

As that section does not define the terms "land" and "sale of land", they must be given their ordinary and commonly accepted meaning, and that is the meaning which the District Court did give them. In so definding them the court correctly pointed out that since there is no reference in the section to leases of land or to various kinds of land tenure, the section must be interpreted as referring to a sale by one who is the owner, and not to an assignment of a lease by a lessee.

The Regulations promulgated under Section 117 (j)(3) support the decision here for they state specifically that a leasehold or estate for years is not

"land" for the purposes of this section. The same regulation was again issued after Congress included a section corresponding to Section 117(j)(3) in the Internal Revenue Code of 1954. This regulation is a reasonable interpretation, and should be given weight as the contemporaneous construction by the officials charged with the administration of the revenue laws.

The Congressional Committee reports relative to Section 117(j)(3) do not define or explain the terms therein which are under consideration here, and such reports do not support taxpayer's contention. These reports do indicate that Section 117(j)(3) was enacted because of a conflict in the cases pertaining to sales of unharvested crops, but it is significant that in each case referred to the crops had been sold simultaneously with a sale of land by the owner thereof. Thus in no case brought to the attention of Congress was there a sale of a lease by a lessee, and there is nothing to indicate that in enacting Section 117(j)(3) Congress gave any consideration to the precise issue here.

ARGUMENT

The District Court Correctly Held That the Gain Realized from the Sale of Taxpayer's Unharvested Crops Should Be Taxed As Ordinary Income

During its fiscal year ending April 30, 1952, the taxpayer, a California corporation, sold the leases which it held on several parcels of farm land together with the unharvested crops on such land to Wheeler Farms, a partnership. Taxpayer treated the gain from the sale of the unharvested crops, as well as that

realized from the sale of the leases, as long term capital gain, and contends that it was authorized to do so by Section 117(j) of the Internal Revenue Code of 1939 (Appendix, *infra*). But the Commissioner held that the sale of leases can not be construed as a sale of land within the meaning of Section 117(j). Thus he determined that the portion of the gain attributable to the sale of the crops should be taxed as ordinary income, and the District Court decided that the Commissioner's determination was correct.

A. *Provisions of Code Section 117(j)*

Paragraph (2) of Section 117(j) provides that if, during the taxable year, the recognized gains from the sales of "property used in the trade or business" exceed the recognized losses from such sales, such gains "shall be considered as gains" from the sales of capital assets;[1] and Paragraph (1) provides that for the purposes of Section 117(j) the term "property used in the trade or business" shall include, among other things listed, (1) property used in trade or business of a character which is subject to depreciation and has been held for more than six months, (2) real property which is used in trade or business and held for more than six months, but which is not the kind includible in an inventory, or is not property held by the taxpayer primarily for sale in the ordi-

[1] Prior to the amendment of the Code by the addition of Section 117(j) the only property to which capital gains treatment could be given was "capital assets" and such assets were and still are defined in Code Section 117(a) as excluding property used in trade or business.

nary course of the trade or business and (3) *unharvested crops to which Paragraph (3) is applicable.* Paragraph (3) of Section 117(j) was added to the 1939 Code in 1951 and provides:

> *Sale of land with unharvested crop.*—In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged * * * at the same time and to the same person, the crop shall be considered as "property used in the trade or business."

From the above statutory provisions it is apparent that the gain realized from the sale of unharvested crops can be considered as capital gain only when the conditions of Section 117(j)(3) have been met and these conditions are set forth in clear and unambiguous language. First there is the title of paragraph (3) indicating its limited scope, namely, that it refers only to *a sale of land with unharvested crop.* Next there is the provision therein stating that an unharvested crop on land which has been used in the trade or business and which has been held for more than six months may be treated as property used in trade or business (and so subject to capital gains treatment) *if the crop and the land are sold*[2] *at the same time and to the same person.* We submit that the language in the "if" clause in this provision is so

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[2] As taxpayer points out (Br. 29) the above clause does use the words "sold or exchanged" but it is admitted the transaction here was a sale and we do not see that there is anything significant about the use of the word "exchanged" or anything that can be said relative to it which is helpful to the taxpayer here.

plain and simple that there should be no doubt as to its meaning or that the District Court has interpreted it correctly but it must be analyzed further since the taxpayer's brief presents a long and involved argument in attempting to show that the sale of the leases here should be treated as a sale of land.

There are no cases involving the precise issue here, and the statute contains no definition of the term "land"which is the key word. Thus we must be guided by the long established rule that the language of a statute is to be given its usual and ordinary meaning for in the absence of any definitions, it must assume that Congress intended the words it used to be given their ordinary and commonly accepted meaning. *Helvering* v. *Flaccus Leather Co.*, 313 U.S. 247, 249; *Old Colony R. Co.* v. *Commissioner*, 284 U.S. 552, 560. In applying this rule of statutory construction here, the District Court pointed out that the ordinary meaning of "land" and its definition under the law of California are the same and then gave the following definitions (R. 24):

> Webster's New International Dictionary, 2d edition, defines land as "the solid part of the surface of the earth as distinguished from water constituting a part of such surface". Black's Law Dictionary, 4th edition (1951) states that "Land, in the most general sense, comprehends any grounds, soil, or earth whatsoever; as meadows, pastures, woods, moors, waters, marshes, furzes and heath. Co. Litt. 4a". Section 659 of the California Civil Code states that "Land is the solid material of the earth, whatever may be the ingredients of which it is composed, whether soil, rock or other substance."

Taxpayer agrees (Br.11, 19) that the term "land" refers to the solid substance of the earth but asserts that the District Court's opinion overlooks that such substance may be possessed in different ways, from a tenancy at sufferance up through more permanent degrees of land tenure. This contention which sets forth the various intricacies of land tenure was well answered by the District Court when it said (R. 23, 25):

> Counsel for the plaintiff argues with great earnestness that Congress in enacting paragraph 3 was concerned only with land tenure or use, and not land ownership. It is to be noted that the words "land tenure", "land use", "use of land", "lease", "real property" or similar expressions do not appear in the statute. The critical phrase in the statute is "if the crop and the land are sold * * *". * * *
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> It is my view that the phrase "if the crop and the land are sold" clearly means the ownership of the land and does not mean "if the crop and the right to the use of land are sold", as urged by the plaintiff.
>
> This meaning is not changed by the clause in the statute which reads "in the case of an unharvested crop on land used in the trade or business and held for more than 6 months". That clause is modified by the clause "if the crop and the land are sold".

The District Court also explained (R. 24-25) that in California leases or estates for years do not come within the term "land" but are treated as personal property. See *Dabney* v. *Edwards*, 5 Cal. 2d 1, 53 P.

2d 962; *Potts Drug Co.* v. *Benedict*, 156 Cal. 322, 104 Pac. 432; *Jeffers* v. *Easton Eldridge & Co.*, 113 Cal. 345, 45 Pac. 680; *Kreling* v. *Walsh*, 77 Cal. App. 2d 821, 176 P. 2d 965; *Santa Barbara* v. *Maher*, 25 Cal. App. 2d 325, 77 P. 2d 306. Taxpayer asserts (Br. 23-24) that these California cases do not support the proposition for which they were cited by the District Court but we do not agree. However even if they were not correctly interpreted, it does not follow that the court's decision is wrong or that it was based entirely on California law. Instead, we think it is apparent that in interpreting Section 117(j)(3), the District Court was primarily influenced by the ordinary and commonly accepted meaning of the language used therein. Certainly the District Court would have reached the same result without considering California law.

In this connection we point out that it is doubtful how much, if any, consideration should be given to local law in cases like this one. Obviously to interpret Section 117(j)(3) properly, the terms "land" and "sale of land" should be given the same definitions throughout the United States. Moreover, as we have already indicated, in the absence of statutory definitions, those terms must be given their usual and ordinary meaning and we submit that is the meaning which the District Court adopted here. Certainly it is fair to say that if the average person should be asked to explain what is meant by a sale of land he would answer that it is the disposition of the actual soil or substance of the earth by one who is the owner and holds fee title thereto; and that he would not treat an

assignment of a lease by a lessee as a sale of land for such lessee is not commonly thought of as an owner or as a person in a position to sell the land he has leased.

B. *Regulations applicable to Section 117(j)(3)*

After the enactment of Section 117(j)(3) late in 1951, Section 29.117-7(d) of Treasury Regulations 111 (Appendix, *infra*) was amended on February 3, 1953, by T.D. 5980, 1953-1 Cum. Bull. 65, and provides so far as pertinent here, as follows:

> (d) *Unharvested crops.*—The conditions referred to in (a)(1)(v) above are: (1) the unharvested crop is on land which is "section 117(j) property", as defined in (a)(3) above, and such land has been held for more than six months; (2) such crop and such land are sold, exchanged, or converted at the same time and to the same person; * * * *A leasehold or estates for year is not "land" for the purpose of this section.* (Italics supplied.)

In view of the last sentence in the above regulation, it is evident that the decision of the District Court is entirely in accord with that regulation, and from what we have already said under Subdivision A, it is equally apparent that the regulation is a reasonable and proper interpretation of Section 117(j)(3). Consequently weight should be given to the regulation for as this Court stated in *Gray Line Co.* v. *Granquist*, 237 F. 2d 390, 394, administrative determination should govern where it is neither arbitrary nor unreasonable.

This Court's statement in the *Gray Line Co.* case is in accord with many other cases holding that Regulations which are not unreasonable or plainly inconsistent with the statutory purpose should be given effect as contemporaneous construction by the agency which Congress has charged with the enforcement of the Act. *Helvering* v. *Reynolds Co.*, 306 U.S. 110, 115; *Citizens Nat. Trust & S. Bank of Los Angeles* v. *United States*, 135 F. 2d 527, 529 (C.A. 9th); *Commissioner* v. *Plestcheeff*, 100 F. 2d 62 (C.A. 9th).

We are aware, of course, that the above regulation has been in effect for only five years. However it is significant that the Treasury Department has subsequently reissued the same regulation twice. See Section 39.117(j)-1(d) of Regulations 118, promulgated under the 1939 Code and applicable to years beginning after December 31, 1951, and Section 1.1231-1 of Treasury Regulations on Income Tax issued under the 1954 Code.

Attention is also called to the fact that the provisions of Section 117(j)(3) of the 1939 Code are substantially the same as Section 1231(b)(4) of the 1954 Code (26 U.S.C. 1952 ed., Supp. II, Sec. 1231) and that the 1954 Code was not enacted until more than eighteen months after the regulation on which we rely here was promulgated. Thus we think it may be assumed that Congress had knowledge of the construction placed upon Section 117(j)(3) by the officials charged with the administration of the revenue laws and that if Congress had considered such construction erroneous, it would not have enacted the same provision as Section 1231(b)(4) of the 1954

Code. Since Congress failed to change this statutory provision, we may assume that it did not find Section 29.117-7(d) of Regulations 111 inconsistent with the intent of the statute. See *Mass. Mutual Life Ins. Co.* v. *United States*, 288 U.S. 269, 273. For these reasons the regulation may be accepted as a proper interpretation of Section 117(j)(3).[3]

C. *Committee reports applicable to Section 117(j)(3)*

In attempting to show the incorrectness of the District Court's decision, taxpayer has relied (Br. 13-17) on the Congressional Committee reports relating to Section 117(j)(3) but as we shall now point out those reports do not support the taxpayer's contention.

The District Court also discussed these reports and has set out two of them in its opinion. (R. 26-28.) In this connection the District Court explained that it had considered the reports "Notwithstanding my belief that the language of the statute is clear" (R. 25); and in conclusion stated "I find nothing in the Committee Report which causes me to change my view as to the plain meaning of the statute" (R. 28-29). The District Court's analysis of the committee reports is clearly correct for there is absolutely

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[3] In contending that the above regulation should not be applied here taxpayer has objected particularly to its being given retroactive effect, as in this case, but the dates given by taxpayer (Br. 11) show that it is in error in stating that the regulation was retroactive for a three year period. However that is not material since the regulation is merely the construction placed on the statute by the administrative officials charged with its enforcement and has not taken away any rights granted by Congress.

nothing in the two reports appearing in the court's opinion or in the supplemental report of the Finance Committee set out in the Appendix, *infra*, to indicate that the court's interpretation is contrary to the intent of Congress.

It will be seen that while these reports contain a few references to "land" and "sale of land" they do not define those terms nor give any indication that such terms are to be given the meaning contended for by the taxpayer here. There is a statement in the supplemental report to which we referred above that the privilege of treating unharvested crops as property used in trade or business is granted *under certain conditions*. Thus it is clear that such crops can not always be so treated and we think it is evident that the conditions were not met here.

As the District Court pointed out (R. 21, 28) and as the first report of the Finance Committee indicates (R. 26), the provision appearing in Section 117 (j) (3) was added to the 1939 Code because of the conflict in certain cases and also because of a ruling of the Bureau of Internal Revenue. The latter stated that the gain from the sale of unharvested crops should be treated as ordinary income although the sale was made simultaneously with the sale of the land on which the crop was growing and was made to the same person. Among the cases just referred to was one by this Court in *Watson* v. *Commissioner*, 197 F. 2d 56, affirmed, 345 U.S. 544, which agreed with the Bureau's ruling.[4] But in view of the enact-

[4] As Section 117(j)(3) was enacted before the Supreme Court's decision was rendered in the *Watson* case, *supra*, it

ment of Section 117(j)(3), it is not necessary now to consider what the various cases held. It is however important to note that in all of them the simultaneous sales of unharvested crops and land had been made *by the owners of the land* and this is not denied by the taxpayer. Thus no case brought to the attention of Congress involved a sale of a lease by a lessee. Consequently the specific issue which taxpayer raises here had not been raised in any of the cases referred to and there is no evidence that Congress gave any consideration to this issue.

As further support for its contention taxpayer cites (Br. 14-15) statements made by Senators Humphrey and Holland on the floor of the Senate when the provision in Section 117(j)(3) was being debated but there is nothing in their statements to support taxpayer's contention. Moreover, it is a recognized rule of statutory construction that statements made in Congressional debates are not considered as authoritative as Committee reports. Particularly is that true when the statements are made by Senators who are not members of the Committee in charge of the proposed legislation. The Congressional Directory for 1951 (the year in which the statutory provision involved here was enacted) shows

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was brought to the Supreme Court's attention although it could be given no retroactive effect. But in commenting on it, the Supreme Court pointed out (p. 548) that it embodied an affirmative statement by Congress which was needed in order to allow gain from the sale of an unharvested crop to be treated as capital gain. The Supreme Court also stated that the addition of Section 117(j)(3) to the Code emphasized the point that the question was one of federal law.

that neither of the above Senators was on the Finance Committee which is, of course, the one reporting on revenue matters.

Taxpayer also refers (Br. 14) to a statement by Senator George who was chairman of the Finance Committee. While a statement by a Senator in that capacity is entitled to more weight than that made by the other Senators, it will be seen that what Senator George said does not help the taxpayer for it fails to show that Section 117(j)(3) should be given an interpretation different from that adopted by the District Court.

CONCLUSION

The decision of the District Court is correct and should be affirmed.

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APPENDIX

Internal Revenue Code of 1939:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * *

(j) [As added by Sec. 151(b), Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Sec. 127, Revenue Act of 1943, c. 63, 58 Stat. 21, Sec. 210(b), Revenue Act of 1950, c. 994, 64 Stat. 906, and Secs. 323, 324 and 325, Revenue Act of 1951, c. 521, 65 Stat. 452] *Gains and Losses from Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in subsection (a)(1)(C). Such term also includes timber or coal with respect to which subsection (k)(1) or (2) is applicable and unharvested crops to which

paragraph (3) is applicable. Such term also includes livestock, regardless or age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition. Such term does not include poultry.

(2) *General rule.*—If, during the taxable year, the recognized gains upon sales or exchanges or property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion * * * of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. * * *

(3) *Sale of land with unharvested crop.*—In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted as described in paragraph (2)) at the same time and to the same person, the crop shall be considered as "property used in the trade or business."

(26 U.S.C. 1952 ed., Sec. 117.)

Treasury Regulations 111, promulgated under Internal Revenue Code of 1939:

Sec. 29.117-7 [as amended by T.D. 5980, 1953-1 Cum. Bull 65]

(d) *Unharvested crops.*—The conditions referred to in (a)(1)(v) above are: (1) the un-

harvested crop is on land which is "section 117 (j) property", as defined in (a) (3) above, and such land has been held for more than six months; (2) such crop and such land are sold, exchanged, or converted at the same time and to the same person; and (3) no right or option is retained by the taxpayer, at the time of the sale, exchange, or conversion, to reacquire, directly or indirectly, the land (other than one customarily incident to a mortgage or other security transaction). The length of time for which the crop, as distinguished from the land, has been held is immaterial. A leasehold or estate for years is not "land" for the purpose of this section.

S. Rep. No. 781, Part 2, 82d Cong., 1st Sess., pp. 42-43 (1951-2 Cum. Bull. 545, 574):

SECTION 323. SALE OF LAND WITH UNHARVESTED CROP

This section, for which there is no corresponding provision in the House bill, amends section 117(j) of the code (relating to sale, exchange, or conversion of property used in the trade or business) to provide that, under certain conditions, an unharvested crop shall be considered as property used in the trade or business. Whether gain or loss from the sale, exchange, or conversion of such a crop will, as a result of this amendment, be treated as gain or loss from the sale or exchange of a capital asset held for more than 6 months will depend upon the application of section 117(j) to that and other transactions of the taxpayer.

* * * *

Subsection (a) (2) adds a new paragraph (3) to section 117(j) to provide that when an un-

harvested crop on land used in the trade or business and held for more than 6 months is sold or exchanged (or compulsorily or involuntarily converted as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) with such land and at the same time and to the same person, such crop shall be considered as "property used in the trade or business." The length of time for which the crop, as distinguished from the land, has been held is immaterial.

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